

dollars. Of course, nothing can be scarce or abundant except at a given price ratio. If expectations concerning relative scarcities change, but a fixed price ratio is maintained, an untenable situation arises. This is a very old experience, commonly known as Gresham's Law. (Gresham died in 1579.)

If any of the three problems deserved priority, it would have been the problem of confidence. How illogical it is to design a system that provides additional reserves but makes no provisions to safeguard against the destruction of existing reserves.

I shall present my views on the position of the United States regarding all three problems. I shall follow the example of the Council of Economic Advisers and begin with the problem of adjustment.

THE ADJUSTMENT PROBLEM

The Report of the Council discusses this problem under two headings, "Adjustment Process" and "The U.S. Balance of Payments." Their analysis of the problem suffers from a failure to distinguish different kinds of approach to the problem of reducing or removing an imbalance of international payments.

They do distinguish "temporary measures" from policies that are "long term in character," but this leaves open the question whether the temporary measures have only temporary effects or long-lasting effects. If I discover a leak in a pipe and press my thumb against the hole, this is a temporary measure with only temporary effect: as soon as I remove my thumb, the leaking resumes. If I discover a bleeding cut on my finger and put a band-aid over it, this temporary measure may have lasting effects, because the wound may heal, the lesion of my skin disappear. The difference between these temporary measures is essential; to call both of them "leak-stopping policies" and be silent on the question whether they are palliatives or cures is not very helpful.

For some 250 years economists studying international finance have known the process of economic adjustment that would remove imbalance and restore balance. This adjustment involves changes in relative prices and incomes in the countries concerned, resulting in changes in the allocation of productive resources and in the international flow of goods and services. The process had originally been conceived as an automatic one, but it can be fully automatic only under monetary institutions that no longer exist. Hence, deliberate adjustment policies are now required to produce the effects which the conceivably automatic mechanism would have produced. These policies do not, however, include every type of measure, including direct controls, that may be instituted for the purpose of removing a payments deficit.

In medicine, no one would doubt for a moment that there is a difference between a surgical operation or some other painful treatment and a disappearance or removal of the need for it. There may be some alternative therapeutic techniques that could remove the need for the painful one; or perhaps the affliction may disappear all by itself. The same possibilities exist for balance-of-payments troubles: with luck, the troubles may go away or some other therapy may make it unnecessary to go through the operations which economists have called the adjustment process. I use the term "compensatory corrections" or "correctives" to indicate those things that are considered as alternatives to the adjustment process.

REDUCING THE PAYMENTS DEFICIT: ALTERNATIVE METHODS

We need even more distinctions. There are measures that do not remove deficits but facilitate financing them. For example, if an increase in interest rates attracts short-term capital from abroad, one may not want to regard this as a credit item in the balance of payments that removes a deficit, but may prefer to regard as a temporary stopgap, a way of financing an existing deficit for a while. (As soon as the attractive interest differential is terminated, the inflow of short-term capital will stop and what has been received will flow back.) In addition, we should separate measures that work on the flow of goods and services from those that work on the flow of capital funds. The adjectives "real" and "financial" can be used for this purpose.

We thus distinguish real adjustment, real correctives, financial correctives, corrective management of government transactions, and external financing.

To *finance* a deficit is to pay for it by reducing the net monetary reserves or by increasing liquid liabilities to foreigners incurred just for this purpose. (If an increase in foreign liabilities arises from an increased foreign demand for dollar balances and other dollar assets, it should be treated as an autonomous capital